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Frequently Asked Progressive Consumption Tax Act Questions

What is a consumption tax?

A consumption tax is a tax that is imposed on goods, services, and other items sold, exchanged, or consumed. Unlike income taxes, which are imposed on earnings (including savings), consumption taxes are imposed on consuming. Consumption taxes can come in many forms. The most common forms are “indirect” taxes like a retail sales tax or a value added tax.

What is a goods and services tax or value added tax?

A goods and services tax (GST) or value added tax (VAT) is a type of consumption tax that is collected on the amount by which the value of an article has been increased, or the “value added,” at each stage of its production or distribution. Thus, from the perspective of a consumer, a GST or VAT looks like a flat sales tax levied on a good or service. But, from the perspective of a business, it is a tax only on the value added to a product or service by that business.

Because tax is collected and remitted on value added at each stage of production and distribution, value added taxes are harder to evade than flat sales taxes.

How are value added consumption taxes levied and collected?

The most common method for implementing a value added tax is called the “credit-invoice” system or method. The *Progressive Consumption Tax Act* (PCTA) uses this system. Under a credit-invoice system, businesses collect and remit the consumption taxes imposed on the goods and services that they sell or distribute. These businesses can also claim a credit for the consumption tax they previously paid on inputs—the business purchases they used to produce or distribute their own goods and services.

A common alternative to the credit-invoice method is a “subtraction method” consumption tax. Typically, the subtraction system uses businesses’ accounting records to calculate value added, and imposes a consumption tax on that amount.

How many other countries have value added consumption taxes?

Approximately 150 countries worldwide have some form of a GST or VAT. Except for the United States, all countries that are members of the Organisation for Economic Cooperation and Development (OECD)—countries with advanced economies similar to that of the United States—have a value added consumption tax. For countries seeking admittance to the European Union (EU), the adoption of a value added tax is a prerequisite for membership, due partly to the trade benefits that a GST or VAT provides.

Much has been made of the fact that the United States currently has the highest statutory *corporate* rate of all the OECD countries. However, this analysis does not take into account the fact these countries also impose a GST or VAT. Below is a table that compares current U.S. tax rates, OECD country averages, and rates imposed under the PCTA.

Country	Top marginal individual income tax rate, 2013	Top marginal corporate income tax rate, 2014	General consumption tax rate, 2014
United States (current)	39.6%	35%	0%
OECD average (unweighted)	36%	23%	19.2%
United States under PCTA	28%	17%	10%

Source: Latest data from OECD Tax Database, available at http://www.oecd.org/tax/tax-policy/tax-database.htm. In addition, the April 2014 consumption tax increase in Japan is included in the OECD unweighted average.

What are the typical policy critiques of consumption taxes?

While technical critiques of different consumption taxes vary across systems, value added consumption taxes face two main policy critiques:

Regressivity. Consumption tax systems are often considered to be inherently regressive since low- to middle-income households spend a greater percentage of their income than high-income households do, and so a consumption tax hits them harder. The *Progressive Consumption Tax Act* counters this directly with significant income tax exemptions, called "family allowances," and Progressive Consumption Tax (PCT) rebates based on income.

Open Spigot. Consumption taxes are often criticized for allowing governments to raise money too easily and without adequate transparency. For those who have this concern, enacting a consumption tax could mean enacting a new and easy-to-adjust lever to raise taxes irresponsibly. The *Progressive Consumption Tax Act* addresses this concern with a circuit breaker that returns overages from the PCT to taxpayers when revenues exceed predetermined levels.

How does a consumption tax affect savings?

Income taxes have a discouraging effect on savings because they are levied on all taxable income, including savings. Consumption taxes do not tax earnings, including savings. Instead, consumption taxes focus on income. If an individual or household spends less, they pay less tax.

Consumption taxes are considered “temporally efficient.” This means that a consumption tax does not affect families’ choices between current and future consumption, since savings are not taxed. Taxing interest, dividends, and capital gains, as under income tax, results in less investment and savings.

How does a consumption tax affect economic growth?

According to both economic theory and recent research on OECD countries’ value added taxes, income taxes are associated with slower long-term economic growth than taxes on consumption.

Recent research on OECD countries’ value added taxes indicate that consumption taxes are associated with greater growth of Gross Domestic Product (GDP) per capita compared to income taxes. In a study that examined 35 years of data on 21 OECD countries, consumption taxes are found to be more growth-friendly than both personal income taxes and corporate income taxes. Corporate income taxes, especially, appear to have the most negative effect on GDP per capita. This evidence suggests that growth-oriented tax reform should move away from income tax revenues and towards consumption tax revenues, as the PCTA does.

In theory, because income taxes levy a tax against savings, taxpayers will choose to do less saving and more current consumption. This arguably results not only in less investment but also less economic growth and lower future living standards, since future consumption is reduced both by the extra current consumption caused by the tax on savings and by the foregone returns that greater savings would have produced.

Who supports consumption-based tax reform?

While preferences on consumption-based tax reform will vary from proposal to proposal, in general, consumption taxes have been historically favored by many policymakers, economists, and others—ranging from Alexander Hamilton (who wrote in Federalist No. 21 on the advantages of consumption taxes) to Bill Gates (who recently spoke in favor of a progressive consumption tax).

Development of the Progressive Consumption Tax Act (PCTA)

Why introduce the PCTA now?

The PCTA was introduced in the 113th Congress to give legislators, policymakers, and all taxpayers an opportunity to see what this type of tax reform would look like. While consumption taxes are already imposed by all other OECD countries, the PCT would be new to the U.S. tax code.

The initial version of the *Progressive Consumption Tax Act* was introduced in the 113th Congress to provide an opening for discussion and a first opportunity to review legislative language for this type of comprehensive tax reform. Most importantly, the rates included in this version of the PCT have not been evaluated by the Joint Committee on Taxation. The rates in the PCTA have been based on a comparison of U.S. tax liabilities to OECD countries with value added taxes, and a similar plan estimated by the Tax Policy Center. However, depending on the comments and input received, these rates and their structure may change.

After a period of considering comments from stakeholders and analyzing its revenue impacts, the *Progressive Consumption Tax Act* will be reintroduced in the 114th Congress. If you have a suggestion on the *Progressive Consumption Tax Act*, or more questions, please email PCT@cardin.senate.gov.

Have other consumption tax proposals been introduced or discussed in comprehensive tax reform debates?

No consumption tax proposals have been introduced in recent Congresses. However, consumption taxes have long been considered as an option in the comprehensive tax reform debate. National sales taxes have from time to time been considered in Congress since as far back as 1862; special panels, task forces, and Administration reports have included VAT-related recommendations for the past four decades.

Previously introduced consumption-based tax proposals include the "USA Tax" (providing an unlimited deduction for savings, and replacing the corporate income tax with an 11 percent value added tax), the "FairTax" (a national sales tax first proposed in Congress in 1999) and the "X Tax" (a two-part tax that taxes businesses through a subtraction method VAT and taxes individual wage income progressively). The President's Advisory Panel on Tax Reform, formed in 2005 under former President George W. Bush, recommended a partial replacement VAT combined with reductions in the individual and corporate income tax rates. The Panel also considered and enumerated the benefits of a progressive consumption tax plan.

Has Congress passed any consumption tax proposals recently?

Congress has not recently passed any consumption tax bills that have become law.

However, in 2010 the Senate passed a "sense of the Senate" amendment, led by Senator McCain, stating that "[i]t is the sense of the Senate that the Value Added Tax is a massive tax increase that will cripple families on fixed income and only further push back America's economic recovery, and the Senate opposes a Value Added Tax." Senator Cardin voted against this amendment. It is important to note that since 2010, nearly half of the Senate has changed over. Of the 85 Senators who supported Senator McCain's amendment in opposition to a VAT, only 46 remain. The 2010 vote is not representative of the current Senate makeup.

As introduced, the PCTA addresses the arguments against value added taxes raised in the "sense of the Senate" amendment. The PCTA is designed to be at least as progressive as the current tax system and provides rebates to low- to middle-income families so that they will not have to pay the

PCT out-of-pocket. The PCTA is used to lower individual income and corporate income taxes, and so will not result in a "massive" increase overall. The PCTA is also designed with a revenue "circuit breaker" that returns PCT revenues if those revenues rise above an established threshold.

Transition rules to further protect those on fixed incomes is a continuing concern. The PCTA's rebate already provides relief to fixed income taxpayers who rely partly on earned income in retirement (earned income represents about 30 percent of total income sources for people aged 65 or older, according to recent AARP data). In addition, those who rely on Social Security and SSI will, under current law, have their benefits adjusted to take into account any changes in prices due to the PCT (social security benefits represent about 40 percent of total income sources for people aged 65 or older, according to recent AARP data).

Economic recovery is an important consideration. According to long-term empirical studies on OECD countries, consumption taxes are linked with faster long-term economic growth than individual income taxes and corporate income taxes. Thus, consumption taxes should be seriously considered in any pro-growth tax reform debate.

Is the PCTA based on of any other country's consumption tax system?

The PCTA is generally based the modern goods and services taxes (GSTs) employed by Australia, New Zealand, and Canada. While all OECD countries have some kind of VAT, the Australia, New Zealand, and Canada GSTs are considered by commentators to be the most efficient to administer, and the Canadian system provides a model on how a federal VAT can interact with sub-jurisdictions (in Canada's case, its provinces) that already impose a sales tax.

That being said, there are several aspects of the PCTA that are unique, such as the way the PCT revenues are used to maintain progressivity and lower income taxes, and how progressivity is maintained through the use of rebates as opposed to select exemptions or preferential rates in the current income tax code.

What issues still need to be addressed?

As introduced in the 113th Congress, the *Progressive Consumption Tax Act* is meant to provide an opening for discussion and a first opportunity to review legislative language for this type of comprehensive tax reform. Overall, the Act shows how a PCT can make our tax code fair and more effective. However, there are open issues that the Act does not address in its current form.

The biggest of these issues relate to a transition from our current system to the proposed PCTA system. Specific transition issues include: the PCTA's effective date (set now at January 1, 2016 for purposes of this marker legislation); how transactions spanning the effective date should be treated; issues related to large consumer durable goods like motor vehicles and housing; and making the transition fairer for older taxpayers.

Another significant issue is how the PCT as proposed will interact with state and local sales taxes. Resolving this important issue will require discussion with state governments. While Canada's Harmonized Sales Tax (HST) can act as a model, we recognize that the U.S. system poses unique considerations and challenges. Aside from sales tax issues, many states base their income tax systems on the federal system. As with any federal income tax overhaul, this interaction must be carefully considered.

Other open issues include revisions to how the PCT treats certain industries; how to treat small businesses (for instance, by providing a small business exemption); and the type of reporting and enforcement needed to ensure compliance with the new PCT.

It is important to keep in mind that the rates included in this version of the PCTA have not been evaluated by the Joint Committee on Taxation. While the rates in the PCTA have been based on a comparison of U.S. tax liabilities to OECD countries with value added taxes, and a similar plan estimated by the Tax Policy Center, depending on the feedback we receive and other changes to the PCTA, these rates and their structure may change.

How can I submit a comment?

The initial version of the *Progressive Consumption Tax Act* was introduced in the 113th Congress to provide an opening for discussion and a first opportunity to review legislative language for this type of comprehensive tax reform. After a period of considering comments from stakeholders and analyzing its revenue impacts, the *Progressive Consumption Tax Act* will be reintroduced in the 114th Congress. If you have a suggestion on the *Progressive Consumption Tax Act*, or more questions, please email PCT@cardin.senate.gov.

Details on the Progressive Consumption Tax (PCT)

What is the PCT rate set in the PCTA?

As introduced, the PCTA sets the PCT rate at 10 percent.

It is important to keep in mind that all the rates included in this version of the PCTA have not been evaluated by the Joint Committee on Taxation. Since the U.S. is a low-tax country compared to other advanced-economy countries, the PCT will likely be set at a rate below the current OECD average of approximately 19 percent. A score by the Tax Policy Center of a similar plan by Professor Michael Graetz resulted in a revenue-neutral rate of 12.9 percent. However, depending on the Joint Committee on Taxation analysis and the feedback we receive and changes to the PCTA, these rates and their structure may change.

What transactions are subject to the PCT?

The PCT is a very broad-based consumption tax. Thus, almost all goods, services, and other items, unless exempt or zero-rated under the Act, will be subject to the PCT.

Specifically, goods, services, and other items (called “supplies”) are taxable if: (1) the supply is made for consideration; (2) the supply is made in the course of carrying on a trade or business or other type of commercial activity; and (3) the supply is made in connection with the United States.

Other types of commercial activities subject to the PCT include the commercial activities of nonprofits and governments, which will also be required to comply with the provisions of the PCT.

What transactions are not subject to the PCT?

As introduced, there are three types of transactions under the PCT. Taxable transactions include almost all goods, services, and other items. However, there are two additional, narrow classes of supplies that are subject to special rules.

(1) PCT is not levied on "exempt" supplies. There are only four types of exempt supplies: the provision of financial supplies, residential housing, residential rent, and de minimis supplies. Financial products and services are subject to special considerations; additional clarifications will likely be added in the next version of the PCTA.

(2) PCT is payable at a rate of 0 percent on "zero-rated" supplies. The only zero-rated supplies are exports or use of goods, services, and other items (such as rights) outside of the United States.

What is the difference between "exempt" and "zero-rated" transactions?

If a supply is exempt, no PCT is levied on that supply. However, no input tax credits related to that supply may be claimed by the business providing the exempt good or service.

If a supply is zero-rated, a business may still claim input tax credits for the business inputs used to make the zero-rated supply.

How is the PCT collected on transactions subject to the PCT?

The PCT is a credit-invoice consumption tax. Under the credit-invoice method, businesses collect PCT on taxable goods and services that they provide to either another business or consumer. These business are then allowed to reduce the amount of PCT they are liable to remit by a credit equal to the amount of PCT paid to other businesses in purchasing inputs (such as intermediate goods, services, and equipment).

Are there any other special rules that apply to exempt financial products?

A very narrow class of financial products is exempt from the PCT. This narrow class is drawn from the experiences of existing consumption tax systems like those in Australia and New Zealand. Exempt financial products and services include the provision of a bank account, a debit or credit arrangement, a mortgage, a superannuation fund, an annuity, insurance, a financial guarantee, an indemnity, currency, securities, or derivatives. Any products or services ancillary to the provision of these products—e.g., checks provided along with a bank account—must be separately stated and the PCT must be charged for those products or services.

Rules related to financial supplies will be considered before reintroduction of the PCTA in the 114th Congress. In particular, rules similar to those in other GST systems like Australia, will be consider. These rules include providing reduced income tax credits for certain inputs related to financial supplies. Rules for businesses that supply an ancillary amount of financial supplies compared to their total business activity will also be examined.

While other countries have experiences with these issues that are very helpful to draw from, we anticipate that the U.S. financial services industry will have unique challenges that will need to be considered and addressed.

For more information on the application of the PCT to financial products and services, see our [Financial Products and Services Fact Sheet](#).

Who pays the PCT?

The PCT is a consumption tax, and so is ultimately paid by the consumer. However, sellers are required to collect and remit the tax on goods and services they provide. Sellers include not only businesses, but also nonprofits and governments to the extent they engage in taxable transactions.

In certain cases, special collection rules provide that the purchaser, rather than the seller, remit the tax. These special rules apply to imports of goods generally, and imports of services and other items to businesses. The PCT for imported goods is intended to be collected at the border, much like a customs duty. Thus, the importer is liable for the tax. In addition, “reverse charge” rules apply to certain services and other items performed or done outside of the United States, but used within the United States in a trade or business. In these cases, the purchasing business must remit the tax.

Do private consumers need to keep track of PCT charged on their purchases?

No, in general, private consumers—end-users of goods and services—do not need to keep track of PCT charged on their purchases. Under the PCTA, PCT is typically collected and remitted by sellers. Private consumers also do not need to keep track of their PCT liability in order to claim the rebate, which is based on earned income or adjusted gross income.

Is there an exemption for small businesses?

In the 113th Congress version of the PCTA, there is no small business exemption. This is one of the open issues that will be considered going forward. The purpose of this version of the PCTA is to open discussion on this type of reform, and feedback from the small business community on establishing a specific exemption and its level is welcome.

How is the PCT progressive?

The PCTA has two measures that counteract the regressivity inherent in consumption taxes. The first is the large income tax exemption, called a “family allowance,” of $100,000 for joint filers, $50,000 for single filers, and $75,000 for head of household filers.

The second is a PCT rebate designed to counteract the new consumption tax burden and make up for the loss of the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the Additional Child Tax Credit (ACTC). Since the goal is to make the new tax system that includes the PCT as progressive as the current system, these programs aimed at low- and moderate-income families need to be replaced. Therefore, the PCT includes a rebate that replaces each of these components. Individuals and families that do not have an income tax liability would still be able to receive rebates.

More details on the calculation and administration of the rebate are contained in our Progressivity Fact Sheet.

Details on income tax reforms

What are the new income tax exemptions and rates?

As introduced in the 113th Congress, the PCTA provides a significant individual income tax exemption, called a “family allowance,” of $100,000 for joint filers, $50,000 for single filers, and $75,000 for head of household filers. The personal exemption for 2015 is $4,000 and the standard deduction is $12,600 for joint filers, $6,300 for single filers, and $9,250 for head of household filers.

For those who still have an individual income tax liability, there will be three marginal brackets, set at 15, 25, and 28 percent, with the following thresholds:

Taxable Income		Marginal Rate
Over	But Not Over	
Single		
$0	$50,000	15%
$50,000	$250,000	25%
$250,000		28%
Married Filing Jointly		
$0	$100,000	15%
$100,000	$500,000	25%
$500,000		28%
Head of Household		
$0	$50,000	15%
$50,000	$250,000	25%
$250,000		28%

Under current law, there are seven marginal brackets, with a top marginal rate of 39.6 percent that in 2015 applies to taxable income over $413,201 for single filers, $464,850 for joint filers, and $439,001 for head of household filers.

In this version of the PCTA, the corporate income tax rate is lowered to 17 percent. The top statutory corporate tax rate in the U.S. is currently 35 percent.

It is important to keep in mind that all the rates included in this version of the PCTA have not been evaluated by the Joint Committee on Taxation. Depending on the Joint Committee on Taxation analysis and the comments we receive, the rates set out in the PCTA and their structure may change.

How else does the individual income tax change?

The PCTA simplifies the individual income tax. Because an income tax liability is eliminated for most households, many individual income tax preferences are streamlined or removed.

Four major tax benefits are retained: (1) the charitable deduction; (2) the state and local tax deduction; (3) health and retirement benefits; and (4) the mortgage interest deduction.

Individual income tax deductions for alimony payments, investment interest, and gambling losses are also retained because alimony received, investment income, and gambling winnings are included in income under current law. Including these deductions is necessary to prevent the duplicative taxation of alimony payments and to properly measure the net income from gambling and investment.

The foreign tax credit is retained for income taxes paid to a foreign government on income earned outside the U.S. Finally, the individual alternative minimum tax (AMT) would be repealed.

How else does the corporate income tax change?

Aside from the tentative rate change mentioned above, the corporate AMT is repealed in its entirety.

What happens to credits like the EITC?

Because the significant family allowances provided by the PCTA eliminate an income tax liability for most households, the benefits currently provided through refundable income tax credits like the EITC are instead provided through the rebate. For more information on the rebate, please see our Progressivity Fact Sheet.

How does the PCTA interact with other tax reform proposals?

The PCTA makes many changes to the individual income tax. However, as introduced, the PCTA is not meant to foreclose consideration of other corporate income tax reform proposals. Instead, it is intended to add another important proposal to the tax reform debate.

However, comments on the PCTA that will receive the most consideration will be those on the reforms specifically proposed by the PCTA. We do not anticipate making large changes to, for example, corporate international taxation within the current PCTA framework itself.

Details on the Revenue “Circuit Breaker”

Why include a revenue “circuit breaker”?

A major criticism of consumption taxes is based on the concern that the government will become “addicted” to consumption tax revenue. For those who have this concern, enacting a consumption tax means enacting a new and easy-to-adjust lever to raise taxes irresponsibly and without much transparency.

One goal of PCT-based reform is to more reliably raise the revenues that we need to for real investments that benefit all taxpayers—such as investments in defense, health, education, and infrastructure programs. However, the PCT is not meant to be a means to quickly raise revenues while disregarding the effects of higher consumption taxes on U.S. families and employers. Thus, the PCT includes the revenue “circuit breaker” mechanism to address these concerns and to benefit taxpayers.

How does the revenue “circuit breaker” work?

The revenue “circuit breaker” puts cash back into taxpayers’ pockets if PCT revenue in a given year exceeds a certain threshold.

Specifically, under this version of the PCTA, if PCT revenues as a percentage of GDP exceed 10 percent over the calendar year, then any excess revenue will be returned to all individual income tax filers, including those taxpayers who have filed for a PCT rebate. As introduced in the 113th Congress, the *Progressive Consumption Tax Act* returns a flat rebate to single and head of household filers, doubles that rebate for joint filers, and includes additional rebate money for filers with dependents.